SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

October Term, 1968

No. 341

ESTATE OF EUGENE L. FREELAND, Deceased, by SECURITY FIRST NATIONAL BANK, a national banking association, Executor, and VERA GOOD FREELAND, by L. N. TURRENTINE, Conservator,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

MARGARET C. LOWTHIAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioners hereby petition this Court for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit. These two cases were consolidated in the courts below and are joined here in this petition.

Opinions Below.

The memorandum findings of fact and opinion of the Tax Court are unofficially reported by CCH at 25 TCM 1473. An original opinion of the Court of

Appeals, rendered March 8, 1968 [R1; App. 1][1], was modified by an "Order on Petition for Rehearing", issued May 6. 1968 [R1; App. 30]. As so modified the opinion is reported at 393 F. 2d 573.

Jurisdiction.

The original decision of the Court of Appeals was entered on March 8, 1968 [R1; App. 1]. A petition for rehearing was filed on April 8, 1968 [R1]. On May 6, 1968, the Court of Appeals entered an "Order on Petition for Rehearing" denying the petition for rehearing but making certain changes in its opinion. [R1; App. 30]. On May 10, 1968, petitioners filed there a "Motion for Reconsideration of the Petition for Rehearing" [R1]. The Court of Appeals denied that motion on May 23, 1968 [R1]. The jurisdiction of this Court is based on 28 U.S.C. §1254(1).

Questions Presented.

We state here first certain of the facts in order to simplify the questions presented. This is a federal income tax case, involving generally the problem of capital gain versus ordinary income on the sale by the decedent, Eugene L. Freeland, hereinafter referred to as "Freeland," and by his secretary and business associate, Margaret C. Lowthian, hereinafter referred to as "Lowthian", of their respective partnership interests in a landholding partnership, Sam Berger Investment Company, hereinafter referred to, as by the courts below, as "SBIC." As the opinion below shows:

(1) There were two general partners, Freeland and one Sam Berger, hereinafter referred to as "Berger";

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[1]The reference is to the volume of the Record, and to the page of the Appendix, *infra*.

and there were in addition certain limited partners, including Lowthian;

(2) The general business policy of SBIC was required by the partnership agreement to be determined by the mutual consent of the two general partners;

(3) The land acquired by SBIC consisted of 4500 acres, unsubdivided, but as part of the procedure of acquisition an option to purchase 500 acres, out of a designated 800-acre parcel of the land, was given by SBIC to a corporation organized for the purpose, Lake Murray Development Company, hereinafter referred to, as by the courts below, as "LMDC";

(4) Berger directed LMDC, and he, but not Freeland or Lowthian, had a capital interest in that corporation;

(5) LMDC exercised its option to the extent of 150 acres, and engaged in subdivision thereof and construction of homes;

(6) LMDC failed; it became insolvent May 4, 1956. Berger, because of that failure and his own sequential financial difficulties, entered, on August 10, 1956, into an agreement of sale of his partnership interest in SBIC to a nonmember, a group of developers hereinafter referred to as the "Tavares group," despite a provision in the partnership agreement against sale of a partnership interest to a nonmember;

(7) SBIC at no time engaged in any activities to develop or solicit for any of its land, except for said option relation with LMDC, which the courts below referred to as an "interlocking" relation;

(8) After the said date of Berger's sale of his interest, August 10, 1956, SBIC, or rather what was left

of it, was not involved in any manner, not even in that "interlocking" sense, in any plan or any activity to develop, or sell, or offer for sale any of its land;

(9) Berger did not get Freeland's consent to his sale of his interest, and Freeland, approached by the Tavares group after Berger's sale to them, refused to join them in development of the property because that would have meant competition by him with his own clients as civil and structural engineer;

(10) Freeland at first also refused to sell his interest to the Tavares group, but finally, on November 26, 1956, he, and also Lowthian, executed agreements to sell their interests to them.

It is the classification for tax purposes of the gain on those sales which is here involved. If SBIC was then holding its property primarily for sale to customers in the ordinary course of its trade or business, that gain of petitioners was ordinary income; otherwise it was capital gain. In this connection, petitioners contend, and on the basis of the facts stated above, that even if prior to the sale by Berger of his partnership interest, that is, August 10, 1956, SBIC was holding its property primarily for sale to customers in the ordinary course of its trade or business,—which petitioners do not concede, —after that sale by Berger, and because of it and prior events, SBIC's purpose had changed and it was not holding its property primarily for sale to customers in the ordinary course of its trade or business. The questions presented are as follows:

(1) On the basis of the facts stated above, was it not error of law for the Tax Court to conclude, in respect to the period after Berger's sale of his partner-

ship interest, August 10, 1956, that the land was being held by SBIC primarily for sale to customers in the ordinary course of its trade or business?

(2) If, as stated by the court below, as to the original purpose of SBIC regarding the land, the Tax Court "might possibly have properly found in petitioners' favor," had not petitioners, on the question of the said original purpose, carried their burden of proof?

(3) If, as stated by the court below in its original opinion, the petitioners' contentions of change of purpose were "admittedly not without support," and there would "perhaps have been considerable basis for a finding" in accordance with them, had not petitioners, on the question of change of purpose, carried their burden of proof?

(4) In respect to question (3) above, is the answer different if the opinion of the court below is taken instead as modified by its "Order on Petition for Rehearing," with, therefore, the word "wholly" inserted before the words "without support," and the word "some" substituted for the word "considerable"?

(5) Was not the burden of proof in any event on respondent because the case, having once been closed in the Treasury Department, was reopened there, not because the prior decision for petitioners was incorrect, but only because of the amount involved and in order to be consistent with the treatment by another agent of other partners of SBIC?

Statutes Involved.

The statutes involved are set forth in the opinion of the Court of Appeals, and as there set forth appear in the Appendix, *infra*, at pp. 3-4 thereof.

Statement.

The basic elements of fact involved are stated above by way of introduction to the questions presented. We add here certain facts which may be helpful. Berger's interest in SBIC was 20% as general partner, and 20% more as trustee of limited partnership interests of his two sons. Freeland had a 32% interest as general partner, and Lowthian had an 8% interest as limited partner. The remaining 20% was held as a single limited interest by another group, the owners with Berger of LMDC. That group acquired that 20% interest, and the 500-acre option above referred to, as compensation for providing a deposit for off-site improvements required by SBIC's vendor. Lowthian sold her interest to the Tavares group at the same time Freeland did, and the latter 20% group sold theirs to the same vendees on October 31, 1957.

A fair statement of the remaining background of this case is contained in the quotations by the court below from the findings of the Tax Court. However, two paragraphs of the Tax Court's findings, giving the genesis of the case in the Treasury Department, were omitted by the court below and are included herein separately, in the Appendix, *infra,* at page 29.

As it appears there, this case was originally closed in the Treasury Department on the basis of allowance of the claims of Freeland and Lowthian in their respective returns that their gain on the sale of their partnership interests was capital gain. Subsequently the cases were reopened there because of the amount involved and "in the interest of being consistent" with the determination made by another agent involving other members of SBIC. Those other members were the 20% group of

limited partners above referred to. The agent in their cases determined that the gain by them on the sale of their interests in SBIC was ordinary income and not capital gain. Instead of going to the Tax Court as Freeland and Lowthian did, however, they paid the additional taxes, filed claims for refund, and went into the United States Court of Claims. That Court, on June 14, 1968, after a careful study of the opinion herein below, finally decided nevertheless in their favor.[2] As a result, the consistency which the Treasury Department demanded by reopening the case of the petitioners herein was lost in a reverse conflict between the court below and the United States Court of Claims. It is in this context that we come before this Court.

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[2]There were two cases in the Court of Claims, *Morse v. United States,* reported at 371 F. 2d 474 (January 20, 1967), and *Ginsburg v. United States* and *Balton v. United States,* consolidated, ... F. 2d ..... (June 14, 1968). Just before the decision in *Morse* was rendered, on December 30, 1966, the decision of the Tax Court herein was filed, and on the basis of that decision the government, on February 20, 1967, filed a motion for reconsideration in *Morse*. At the same time that the Court of Claims rendered its decision in *Ginsburg* and *Balton*, June 14, 1968, it denied the government's motion for reconsideration in *Morse*.

REASONS FOR GRANTING THE WRIT.

1. The Decision Below Is in Clear Conflict With the Decisions of the United States Court of Claims in Morse v. U.S., 371 F. 2d 474 (January 20, 1967), and the Consolidated Cases of Ginsburg v. U.S. and Balton v. U.S., ... F. 2d ..... (June 14, 1968).

In *Morse* the Court of Claims, in respect to the sale by another partner of SBIC of his partnership interest, reached a conclusion the exact opposite of the opinion below. In *Ginsburg* and *Balton,* involving still other partners, the Court of Claims followed its conclusion in *Morse.* While the sales of partnership interests involved here took place November 26, 1956, and the sales involved there all took place October 31, 1957, almost a year later, those cases base their conclusion as to change of purpose on precisely the same events as those on which petitioners relied here. Those events were events terminating with the sale by Berger on August 10, 1956, events thus distinct from, and terminating well before, the sales involved here. See the opinion herein of the court below, Appendix, *infra,* at page 25 and that of the Court of Claims in *Ginsburg* and *Balton,* slip opinion, pages 4-5, 7.

Stating this very clearly the Court of Claims there says, at pages 4-5, in reference to its previous opinion in *Morse:* "It was our view that, no matter what the business of the partnership prior to the August date, the preponderance of the evidence indicated that all the problems and circumstances leading up to, and in-

cluding, Berger's contract of sale induced the partnership to give up its plans for developing the land and instead to continue to hold it but as investment property." Even more clearly showing that that court found the change of purpose to have already taken place at the time of Freeland's sale, footnote 14 on page 10 of the slip opinion in *Ginsburg* and *Balton* reads as follows: "We add that, in any event, we tend to the view, though we need not decide definitively, that the defendant has not given us a convincing reason for concluding that the property was held by the partnership as inventory on November 26, 1956, when Freeland and Lowthian sold their shares."

As the opinion there also shows, slip opinion, page 5, the government itself contended there that there was a conflict between *Morse* and the opinion herein below. The government there further contended, as shown at page 8 of the slip opinion, that on August 10, 1956, SBIC had abandoned its "primary purpose." Indeed, the Tax Court herein, as quoted by the court below, seems itself to have recognized this, although subconsciously, when it said, in reference to SBIC's indirect connection with development through LMDC, "the period of gestation was prematurely cut short". (App. 21). There is nothing in that to suggest that it would be attempted again.

The view of the Court of Claims regarding the conflict of opinions above shown, between itself and the courts herein below, is summarized on page 6 of its slip opinion in *Ginsburg* and *Balton*, as follows: "In fulfilling our judicial obligation, we have merely evaluated the facts differently than the Tax Court did in pursuit of its responsibility."

2. The Application by the Court Below of the Taxpayer's Burden of Proof Is in Clear Conflict With Decisions of Other Courts of Appeals and Decisions of This Court.

As to SBIC's original purpose, the court below states that the Tax Court "might possibly have properly found in petitioners' favor". (App. 24). As to petitioners' contentions of change of purpose, the court below there says, in its original opinion, they "are admittedly not without support," and there would "perhaps have been considerable basis for a finding" in accordance with them. As that court modified its opinion by way of its Order on Petition for Rehearing, it inserted the word "wholly" before the words "without support," and substituted the word "some" for the word "considerable." The court did not disclose on what evidence, or lack of evidence, those changes were based, nor did it disclose what those changes were intended to accomplish. But it is clear that the court thereby added to its uncertainty of language an attempt to inject precision of measurement into facts which could be the subject of broad evaluation but not precise measurement. In any case, those changes emphasize the difficulty of the court below in supporting the Tax Court's conclusion that petitioners were wrong, while acknowledging at the same time that the evidence showed they could be right.

The court below allowed the Tax Court's conclusion to stand because the burden of proof was on petitioner. (App. 23). The proof required to support petitioners being of a negative, that the property was not held pri-

marily for sale to customers in the ordinary course of trade or business, the burden of proof is less than if the proof required were of a positive. *Weir v. Commissioner* (C.A. 6) 283 F. 2d 675, 679. But even where the proof required is of a positive, what is required is only the preponderance of the evidence, therefore evidence showing that the facts asserted are more probably true than false. *Burch v. Reading Co.* (C.A. 3), 240 F. 2d 574, 579, cert. denied 353 U.S. 965. This Court has stated that requirement as the evidence which "would reasonably support a verdict for a plaintiff in an ordinary action for the recovery of money." *Burnett v. Niagara Falls Brewing Co.,* 282 U.S. 648, 654, 51 S. Ct. 262, 265; 2 Casey's Federal Tax Practice §8.7 at fn. 45, 9 Mertens §50.62 at fn. 23. We submit therefore that what the court below has in fact said here, in effect, is that petitioners have carried their burden of proof.

The burden of proof rule, moreover, may not be applied to defeat justice. *Helvering v. Taylor,* 293 U.S. 407, 55 S. Ct. 287, 9 Mertens §50.62 at fn. 22, §50.65 at fn. 60. Clearly, the statements of the court below, quoted above, show that the evidence was adequate to support petitioners, so that a decision against them would be inconsistent with justice.

3. The Opinion of the Court Below Is in Conflict With Decisions of This Court by Accepting Factual Inferences Made by the Tax Court on the Basis of Mere Suspicion.

This Court in *Commissioner v. Duberstein*, 363 U.S. 278, 292, 80 S.Ct. 1190, 1200, stated that factual inferences if not "mere suspicion" but factual conclusions based on "informed experience with human affairs" would come within the protection of the "clearly erroneous" rule. The inferences here, however, are framed in the very language of suspicion. Nor do they indicate a basis of informed experience.

For example, the 4500 acres acquired by SBIC, a mere seven square miles, "contained a lake, some canyons, and a mountain rising about 1100 feet above the surrounding terrain." (App. 6). Also, as to the mountain, the cost of offsite improvements was found to be prohibitive even at the foothills. (App. 18). Simple arithmetic would show that even with an average slope as high as 25%,[3] the mountain alone, with a floor radius then of 4400 feet, would rule out as unusable one-third of the 4500 acres. Yet the court below accepts the Tax Court's use of SBIC's average cost per acre based on the entire 4500 acres, including the mountain, in order to treat its selling price to LMDC for the non-mountainous portions of the land as a scheme for despoling the federal revenue. (App. 24).

We give the above only as one example of the character of the inferences made. Most of the others cited by the opinion below are of like character. (App. 23-

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[3]The maximum grade provided in San Diego is 15%, Council Resolution No. 173217.

24). We submit that those inferences, just as their very wording shows, do not rise above the level of mere suspicion.

4. The Opinion Below Is in Clear Conflict With Decisions of This Court in Failing to Apply the Language of the Statute as It Reads.

In *Malat v. Riddell,* 383 U.S. 569, at pp. 571-72, this Court held, in interpreting the word "primarily", as used in Section 1221(1) of the Internal Revenue Code, that that section should be applied as it reads. That section, being the one involved here, excludes from treatment as capital gain the gain on a sale of property held primarily for sale to customers in the ordinary course of trade or business.

The burden of the taxpayer, therefore, in order to show that that exclusion did not apply, would be to show, as observed above under Reason 2, that the property was not held primarily for sale to customers in the ordinary course of trade or business. As the court below concedes, the relevant intent is that held during the period immediately prior to sale. (App. 24-25). The findings as quoted by the court below show beyond any question that during the period immediately prior to the sales involved here, that is, prior to November 26, 1956, both LMDC and Berger then being out, the property was not held either primarily or at all for sale to customers in the ordinary course of trade or business. The court below makes no attempt to contest or in any manner to question this fact. What it does by way of answer is merely to say that during that period the partnership purpose regarding the land was "to some degree not clearly defined." (App. 25-26). If

the purpose was to some degree not clearly defined, just how it could be a purpose *primarily* held, the court below does not explain.

5. The Opinion Below Is in Clear Conflict With Decisions of This Court in Arriving at Its Conclusion by Way of an Obvious Non Sequitur.

This Court in *Tot v. United States,* 319 U.S. 463, 467, held that in arriving from "the fact proved" to "the ultimate fact presumed" reason as found in common experience was necessary. The opinion below in stating the petitioners' contentions on the question of change of purpose says: "They point, first, to the disputes that occurred between SBIC and LMDC; second, to the failure of LMDC; and third, to the sale of Berger's interest in SBIC to Tavares." (App. 25). Then, in the very next paragraph (as restated in its Order on Petition for Rehearing), it says, referring to the Congressional purpose of preventing partners from reducing their tax liability by converting potential ordinary income of the partnership into capital gain by selling their partnership interests: "This purpose would in many instances be frustrated if partners' decisions to sell their interests necessarily sufficed to establish the sort of 'change of purpose' which petitioners contend occurred here."

The implication in the sentence last quoted is that the petitioners were trying to establish a change of purpose of the partnership regarding the land on the basis of Freeland's decision to sell his interest, and Lowthian,

hers, and to apply the change of purpose so established to the determination of the character of the income involved in those very sales. This would, very plainly, be an attempt by the taxpayers to pull themselves up by their own bootstraps. Of course, the Congressional purpose indicated would be frustrated if such an attempt were allowed. But the court below points to no contention made by petitioners, at any point, in any document, attempting to rely for change of purpose upon their decisions to sell their own partnership interests. Thus the court below goes from the actual contentions of petitioners to an assumption of a contention which has no rational connection with them at all. This error is so self-evident that it should not be necessary to refer to any court decision to show it. We refer to the case of *Tot, supra,* nevertheless, in order to show that this Court has had occasion to recognize it.

What the court below may have meant, possibly, by the non sequitur shown above, was that it would not recognize a change of purpose at all, that the controlling purpose was the original purpose and not the purpose immediately prior to the sale involved. If that is true, then of course there is a clear and direct conflict with the United States Court of Claims, as the court below itself shows. (App. 24-25).

6. This Case Is Important Because of the Lack of Consistency Which Would Otherwise Remain in the Treatment by the Government of the Same Identical Facts in Respect to Different Taxpayers.

As observed under "Statement" above, the case here had originally been closed in the Treasury Department in favor of petitioners. It got into court because the Treasury Department reopened the case administratively in order to be consistent with the treatment of the same facts in the case of other partners of SBIC. If consistency was that important to the Treasury Department in its internal functioning, it certainly must be all the more important on the face of reported decisions. We believe that unless this conflict, described under Reason 1 above, is resolved, the harm to the Treasury Department, as well as to equality of justice to taxpayers generally, will be tremendous.

Conclusion.

We submit in conclusion for the reasons given above that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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